

Message Text

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ACTION EUR-12

INFO OCT-01 EA-06 ISO-00 AID-05 CEA-01 CIAE-00 COME-00

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SS-15 NSC-05 H-02 PRS-01 PA-01 USIA-06 AGR-05 /116 W

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TO SECSTATE WASH DC 7460

INFO AMEMBASSY CANBERRA

LIMITED OFFICIAL USE SECTION 01 OF 02 OECD PARIS 14868

E.O.11652: N/A

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SUBJECT: PREVIEW OF EDRC ANNUAL REVIEW OF AUSTRALIA,
JUNE 13

REF: OECD DOCUMENT EDR(75)15

1. SUMMARY: SECRETARIAT SURVEY OF AUSTRALIAN ECONOMY
MAKES CLEAR THAT PRESENT DEGREE OF STAGFLATION LARGELY
DUE TO STOP-GO NATURE OF DOMESTIC POLICY OVER PAST TWO
YEARS. PRESENT EXPANSIONARY STANCE OF DEMAND MANAGEMENT
COINCIDES WITH ONE OF HIGHEST INFLATION RATES IN OECD,
AND IS LIKELY TO PRODUCE ONLY 1.5 PERCENT REAL GROWTH
OF GDP IN 1975. SECRETARIAT BELIEVES PRIORITY MUST BE
GIVEN TO CONTROLLING INFLATION, WHICH COULD BE RISING AT
25 PERCENT ANNUAL RATE BY END OF YEAR. IF VOLUNTARY
PRICE AND WAGE RESTRAINT CANNOT BE ACHIEVED, SECRETARIAT
RECOMMENDS THAT DEMAND MANAGEMENT BE TIGHTENED DESPITE
ADVERSE CONSEQUENCES FOR LEVELS OF ECONOMIC ACTIVITY AND
EMPLOYMENT. IN PARTICULAR, SECRETARIAT CONSIDERS IT
ESSENTIAL THAT THERE BE REDUCTION IN RATE OF GROWTH OF
PUBLIC EXPENDITURE. SECRETARIAT REGRETS IMPOSITION OF
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IMPORT CONTROLS WHICH DELAY ACHIEVEMENT OF MORE EFFI-

CIENT RESOURCE ALLOCATION AND REMOVE IMPORTANT SOURCE OF PRICE COMPETITION FOR DOMESTIC MANUFACTURERS. CURRENT ACCOUNT DEFICIT EXPECTED TO FALL TO ABOUT A\$0.75 BILLION, WHICH SECRETARIAT THINKS CAN BE READILY FINANCED VIA CAPITAL INFLOWS. ACTION REQUESTED: COMMENTS AND QUESTIONS FROM WASHINGTON AND CANBERRA IN TIME FOR ANNUAL REVIEW JUNE 13. END SUMMARY.

2. GENERAL OUTLOOK: SECRETARIAT ATTRIBUTES PRESENT DIFFICULTIES OF AUSTRALIAN ECONOMY IN LARGE PART TO GOA POLICIES OF EXCESSIVE EXPANSION IN 1972-73, EXCESSIVE CONTRACTION IN 1974, AND NOW ONCE AGAIN STRONG EXPANSIONARY POSTURE AT TIME WHEN INFLATION RATE IS ONE OF HIGHEST IN OECD. SECRETARIAT BELIEVES THAT DOWNTURN MAY NOW HAVE BOTTOMED OUT AND THAT ECONOMY IS TURNING AROUND, BUT PROSPECTS ARE FOR SLOW GROWTH OF DEMAND AND ACTIVITY IN 1975, DESPITE EXPANSIONARY STANCE OF FISCAL AND MONETARY POLICY. UNEMPLOYMENT IS LIKELY TO REMAIN AT HIGH LEVEL INTO 1976 AND RECENT RAPID RATES OF PRICE AND WAGE INCREASES MAY ACCELERATE FURTHER. REAL GDP IS FORECAST TO GROW ABOUT 1.5-2.0 PERCENT, LARGELY DUE TO SUBSTANTIAL TURNAROUND IN FOREIGN BALANCE WHICH WILL ADD 3 PERCENT TO GDP. WEAKNESS OF DOMESTIC DEMAND DUE LARGELY TO EXPECTED DECLINE IN INVESTMENT DURING RECESSIONARY PERIOD, COMPOUNDED BY DELETERIOUS EFFECTS OF CONTINUING RAPID INFLATION ON BUSINESS CONFIDENCE. ONLY HOUSEBUILDING IS LIKELY TO GIVE STIMULUS TO PRIVATE INVESTMENT IN 1975. CONSUMER DEMAND WILL RISE ABOUT 2 PERCENT IN RESPONSE TO PERSONAL INCOME TAX DEDUCTIONS. MAIN STIMULUS WILL COME FROM PUBLIC SECTOR EXPENDITURES WHICH ARE FORECAST TO RISE 8.5 PERCENT IN REAL TERMS.

3. OUTLOOK FOR PRICES AND WAGES: SECRETARIAT CONSIDERS OUTLOOK FOR WAGE DEVELOPMENTS STILL HIGHLY UNCERTAIN AFTER RECENT NATIONAL WAGE CASE, SINCE IT REMAINS TO BE SEEN HOW INDIVIDUAL EMPLOYERS AND UNIONS WILL ACT. SEVERAL FACTORS SUGGEST LIKELIHOOD OF FURTHER ACCELERATION IN INFLATION RATE LATER THIS YEAR, PERHAPS TO AN ANNUAL RATE OF 25 PERCENT BY END OF YEAR. THESE ARE (A) EXPANSIONARY FISCAL POLICY AND ACCOMMODATING LIMITED OFFICIAL USE

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MONETARY STANCE; (B) DELAYED IMPACT OF SEPTEMBER 1974 DEVALUATION ON IMPORTS; AND (C) REDUCTION OF DOMESTIC PRICE COMPETITION DUE TO IMPORT RESTRICTIONS.

4. POLICY STANCE: SECRETARIAT THINKS THAT FIRST PRIORITY SHOULD BE GIVEN TO REDUCTION OF INFLATION RATE. IN VIEW OF LIMITATIONS ON POWER OF GOA TO CONTROL PRICES AND INCOMES, A VOLUNTARY CONSENSUS MUST SOON BE REACHED

OR ELSE DEMAND MANAGEMENT WILL HAVE TO BE MAIN
INSTRUMENT OF ANTI-INFLATION POLICY, WITH UNFORTUNATE
CONSEQUENCES FOR OUTPUT AND EMPLOYMENT. SECRETARIAT
CONSIDERS IT ESSENTIAL TO CURTAIL IMPACT OF BUDGET
DEFICIT ON MONEY SUPPLY, IN PARTICULAR BY REDUCTION
IN RATE OF GROWTH OF GOVERNMENT EXPENDITURE. AT PRESENT,
MONETARY AGGREGATES ARE GROWING RAPIDLY AND HIGH LEVEL

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OF LIQUIDITY IS BUILDING UP, AT LEAST IN PART DUE TO
FINANCING OF 1974-75 GOVERNMENT DEFICIT. SECRETARIAT
ADVISES AGAINST INCREASING TAXES TO IMPROVE REVENUE
POSITION DUE TO NEGATIVE EFFECT ON EFFORTS TO ACHIEVE
WAGE RESTRAINT.

5. BALANCE OF PAYMENTS: SECRETARIAT ANTICIPATES THAT
OVERALL VOLUME OF EXPORTS WILL RISE ONLY SLIGHTLY IN
1975, DUE TO DEPRESSED DEMAND IN FOREIGN MARKETS AND
POSSIBLE ADVERSE EFFECTS ON PRICE COMPETITIVENESS OF
RAPID INCREASES IN UNIT LABOR COSTS. HOWEVER, IMPORTS

EXPECTED TO FALL BY 13 PERCENT DUE TO WEAK DOMESTIC DEMAND AND IMPORT RESTRICTIONS. IMPROVED TRADE BALANCE MAY BE SOMEWHAT ERODED BY DETERIORATION IN TERMS OF TRADE, BUT CURRENT ACCOUNT DEFICIT IN 1975 EXPECTED TO FALL SUBSTANTIALLY TO AROUND US\$0.75 BILLION. SECRETARIAT SEES NO PROBLEM FINANCING THIS DEFICIT BY CAPITAL INFLOWS. SECRETARIAT REGRETS USE OF IMPORT RESTRICTIONS WHICH DELAY PROGRESS TOWARD MORE EFFICIENT ALLOCATION OF DOMESTIC RESOURCES AND REDUCE PRICE COMPETITION ON LIMITED OFFICIAL USE

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DOMESTIC MARKETS.

6. AT EDRC REVIEW, MISSION PROPOSES TO ASK WHETHER WAGE INDEXATION CAN ACHIEVE DESIRED RAPID REDUCTION OF PRICE LEVEL, IN VIEW OF ITS LIKELY EFFECT OF SUSTAINING RELATIVELY HIGH WAGE RATES FOR SOME PERIOD TO COME. (WE NOTE THAT JAPAN HAS SUCCEEDED IN REDUCING WAGE RATES FROM OVER 30 PERCENT IN 1974 BARGAINING ROUND TO UNDER 15 PERCENT THIS YEAR, WITHOUT USING INDEXATION. CAN AUSTRALIA EXPECT AS RAPID A REDUCTION AFTER ADOPTING INDEXATION PROGRAM?) WE PLAN TO ASK ABOUT CHANCES OF ACHIEVING NATIONAL CONSENSUS ON NEED TO RESTRAIN PRICES AND WAGES, AND WHETHER GOA ITSELF IS PREPARED TO CONTRIBUTE TO INFLATION CONTROL BY REDUCING BUDGET DEFICIT AND HOLDING DOWN GROWTH OF MONEY SUPPLY. IN VIEW OF EXPECTED IMPROVEMENT IN BALANCE OF PAYMENTS, WE WOULD PLAN TO ASK HOW SOON GOA WILL BE ABLE TO START DISMANTLING CURRENT IMPORT CONTROL PROGRAM. WE WOULD BE INTERESTED TO KNOW IF PHILLIPS CURVE TRADE-OFF BETWEEN LEVEL OF EMPLOYMENT AND SIZE OF WAGE DEMANDS CAN BE EXPECTED TO WORK IN AUSTRALIAN CONTEXT, AND IF NOT, WHY NOT. IN OTHER WORDS, WOULD THE CLIMATE FOR CONTROLLING WAGE DEMANDS IMPROVE IF UNEMPLOYMENT INCREASES STILL FURTHER?

7. ACTION REQUESTED: MISSION WOULD APPRECIATE COMMENTS AND QUESTIONS IN TIME FOR ANNUAL REVIEW JUNE 13, IN PARTICULAR REGARDING POINTS RAISED IN PARA 6 ABOVE.
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